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Donor Advised Funds: More Than Parking Lots

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Donor-Advised Fund vs. Private Foundation

	Donor-Advised Fund	Private Foundation
Tax Deduction Limits	Cash (**60%** of AGI), Securities (**30%** of AGI), and Other Property (**FMV**)	Cash (**30%** of AGI), Securities (**20%** of AGI), and Other Property (lower of **tax basis** or FMV)
Minimum Distributions	None	5%
Control	Established by Sponsor	Total
Anonymity	Possible if Desired	No
Excise Tax on Net Investment Income	None	1% or 2%
Excise Tax on Excess Business Holdings	Yes (10% of excess and 200% of excess still held)	Yes (10% of excess and 200% of excess still held)
Other Excise Taxes	See Slides 15 and 16	Self-Dealing, Jeopardizing Investments, Taxable Expenditures

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Comparing the Benefits

Donor-Advised Funds

- Higher tax deduction limits
- More optimal for receiving appreciated property
- Anonymity, if desired
- Can receive gifts from PFs, CRTs, and CLTs
- Low cost and hassle
- No separate state and federal filings
- No minimum distributions
- No self-dealing rules
- Possible access to more investment options
- Access to professional philanthropic advisors

Private Foundations

- More family control in operations, grant making, and investing
- Operate in perpetuity, if desired
- Appoint board of directors
- Hire and compensate staff, including family
- Perception of prestige
- Can grant to a DAF
- Can design scholarship and fellowship programs
- Grants to individuals facing hardship, emergencies or medical emergencies
- Can make program-related investments

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Overview

DAF’s allow the donor immediate tax deductions for contributions, but need to ensure that they will not ultimately **return benefits to the donor**.

Accounting and Operational Considerations

- Thank You Letters
  - The individual should not be given a tax receipt by your nonprofit and they are not allowed a deduction for a contribution from their DAF.
- Pledges
  - Donor cannot commit their DAF to fulfill a pledge.
  - If a donor has a pledge that is satisfied by a DAF contribution, the original pledge should be written off and a new gift from the DAF recorded.
- Donor Intent and Correspondence
  - Differences in understanding between the donor and community foundation should be resolved with the community foundation.

Examples of DAF Abuses

1. Donor requests a grant to purchase tickets to a nonprofit’s **special event (i.e. gala)**.
2. Donor asks for a **scholarship** grant to a college for a relative.
3. Donor asks for a grant to a nonprofit in payment of the **donor’s pledge**.
4. Donor asks for a grant to a **private foundation** controlled by the donor.
5. Donor requests funds to be invested in a **loan to the donor**.

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Case Studies

1. Pledges to a Capital Campaign
2. Tickets to the Gala
3. Meeting the Public Support Test
4. The Uncommitted Donor
5. Private Foundation Minimum Distributions
6. The Generous General Contractor
7. Excess Business Holdings

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#1 – Pledges to a Capital Campaign

- **Summary** – A donor wishes to pledge $5M to a nonprofit's capital campaign. The donor intends to satisfy this by recommending the gift from their DAF. The nonprofit is not aware of this and records a pledge from the donor.
- **Problem** – A DAF can't satisfy another pledge of a donor. The prior pledge must be written off to bad debt and a new gift recognized from the DAF.
- **The Fix** – The nonprofit should create a pledge form that clearly asks if the donor intends to satisfy the commitment from a DAF. If so, the nonprofit defers recognition of the pledge until correspondence is received from the DAF.

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#2 – Tickets to the Gala

- **Summary** – A donor wishes to support a nonprofit's gala fundraising by purchasing tickets or a sponsorship from their DAF. The DAF pays for the contribution portion of the gala tickets from the DAF and the donor pays the fair market value of the non-charitable benefit received.
- **Problem** – The IRS has specifically ruled against separating costs associated with fundraising events, referred to as "bifurcation".
- **The Fix** – Explain to the donor that full value of the tickets or sponsorship must be paid from sources **other than** the DAF.

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#3 – Meeting the Public Support Test

- **Summary** – A relatively new public charity is established by a wealthy individual to focus on public policy and advocacy. Much of the contributions come from the donor or a few of their close connections. The organization is approaching the end of its 5 year advance ruling period to qualify for the public support test, but it only has less than a dozen donors. Instead of giving all donations personally, the donors also decide to make contributions from their DAFs.
- **Problem** – Meeting the public support test is important to avoid being considered a private foundation. Generally, public support of more than 33 1/3% must be maintained. Contributions are limited to 2% for "each person", which includes private foundations. However, the IRS has allowed gifts from DAFs to count 100% toward the public support test. Therefore, the organization may continue qualifying as a public charity, despite only having a small donor base.
- **The Fix** – This approach is currently allowable, but proposals may soon limit it.

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#4 – The Uncommitted Donor

- **Summary** – A donor utilizes various philanthropic vehicles (personal donations, private foundation, and a DAF) for their philanthropy. They want to make a commitment to a nonprofit for a grant request, but still have some tax planning to do before identifying the source.
- **Problem** – Making a pledge to the nonprofit, might either personally commit the donor or their private foundation.
- **The Fix** – Send the nonprofit a letter informing them of the intent to make a commitment, but it is not a pledge until they identify the source for satisfying the commitment. The nonprofit will not likely record a pledge, since this is only an intent that does not commit a specific party.

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#5 – Private Foundation Minimum Distributions

- **Summary** – A private foundation needs to meet its 5% minimum distribution for the year, but is only at 3% and still conducting due diligence on a few potential grantees.
- **Problem** – Failure to meet the 5% minimum distribution will result in a 30% tax on undistributed income, and an additional 100% tax on amounts remaining undistributed at the end of the year.
- **The Fix** – The private foundation can make a grant to a DAF to meet the minimum distribution requirement and then subsequently recommend grants from the DAF to the potential grantees. However, there is a proposal to change this.

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#6 – The Generous General Contractor

- **Summary** – A donor recommends a grant from their DAF for a school's capital campaign. The donor happens to own a construction company and has also landed the contract for constructing the building for the capital campaign.
- **Problem** – Donors should not receive any direct or indirect benefit that is a *more than incidental benefit*, or there is an excise tax due under Section 4967. DAF Sponsors may also be subject to tax under Section 4966 if found to knowingly make a taxable distribution.
- **The Fix** – DAF Sponsors should ensure they have performed some due diligence on donors and understand potential threats from donor relationships. Expenditure responsibility should also be performed on the use of the grant funds.

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#7 – Excess Business Holdings

- **Summary** – A donor sets up a DAF by contributing their entire stake in a business. They owned 50% of the business.
- **Problem** – DAFs are subject to a significant excise tax on excess business holdings, which is generally limited to a 20% ownership threshold.
- **The Fix** – DAFs generally have up to five years to reduce their holdings for excess business holdings acquired by donation.

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What Can Go Wrong – IRS Examinations

- Disallowed deductions for donations to the DAF
- Section 4966 excise taxes on Sponsors (i.e. community foundation) and Fund Managers (i.e. officer, director, trustee)
  - Tax assessed for knowingly making taxable distributions
    - Sponsor – 20% tax
    - Fund Manager – 5% tax
- Section 4967 excise tax on donor or related person
  - If a *more than incidental benefit* is directly or indirectly received
  - 125% tax on donor, donor advisor, or related person

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What Can Go Wrong – IRS Examinations

- Section 4958 intermediate sanctions for excess benefit transactions with disqualified persons
  - Any grant, loan, compensation, or similar payment from a DAF to a related person
  - 25% of the excess benefit taxed on disqualified person
  - 200% tax if the excess benefit isn't corrected by year end
  - 10% of the excess benefit taxed on organizational manager
- Deny or revoke charity's 501(c)(3) exemption

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Regulatory Rumblings

- IRS Notice 2017-73
  - Excise tax on distributions to purchase tickets for fundraising events enabling donors or donor advisors to attend
    - Considered a "more than incidental benefit"
    - Applies even if the distribution is only for the charitable contribution portion
    - Applies to distributions to cover deductible portion of membership fees
  - Not considered a "more than incidental benefit" to make a distribution that fulfills a donor's pledge to another charity.
    - However, the sponsor can't make reference to donor's pledge when making the distribution

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Regulatory Rumblings

- IRS Notice 2017-73
  - Public Support Test
    - Contributions to a charity from a DAF is treated as an indirect contribution from the donor for purposes of the public support test
    - Charity also needs to treat all "anonymous" contributions (including DAFs failing to disclose donors) as being made by one person
    - Likely to result in more charities failing the public support test and being treated as private foundations

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Regulatory Rumblings

- Tax Reform Proposals That Didn't Pass
  - DAF sponsors disclosing average amounts of grants made from DAFs
  - DAF sponsors disclosing policies with respect to frequency and minimum level of DAF distributions to identify inactive DAFs
- Other Past Initiatives
  - Mandate DAFs distribute assets within 5-10 years
  - Allow charitable IRA rollovers to be made to DAFs

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IRS Disclosures

- Community foundations and other DAF sponsors must complete Schedule D, Part I of IRS Form 990. Questions include:
  - The total number of accounts at the end of the tax year
  - The contributions added to the accounts
  - The distributions from the accounts
  - The total value of the accounts at the end of the tax year
  - Whether it informed all donors and donor advisors that the assets are the organization's property, subject to their legal control
  - Whether it informed all grantees, and donors that grants may only be used for charitable purposes and not to benefit the donor

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Questions

Thank You!